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November 13, 2003

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: WC Docket No. 02-112, Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; CC Docket No. 00-175, 2000 Biennial Regulatory Review of Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules

Dear Ms. Dortch:

On November 12, 2003, the undersigned, Joseph DiBella, and Fred Moacdieh of Verizon met with Renee Crittendon, Bill Devers, Brent Olson, Ben Childers, Bill Kehoe, and Pam Megna of the Wireline Competition Bureau. The purpose of the meeting was to provide responses to questions raised in an earlier meeting and to explain Verizon's position on the accounting treatment for long distance services provided on an integrated basis after sunset of the section 272 separate affiliate requirements. Verizon argued that the existing rules, which assign the costs of integrated long distance services to the interstate interexchange category in Part 69, should continue to apply. The presentation material used during the meeting is attached.

This notice is being provided pursuant to Section 1.1206(b)(2) of the Commission's rules.

If you have any questions, please contact me directly.

Sincerely,

/s/Clint Odom

Attachments

cc: Renee Crittendon
Bill Devers
Brent Olson
Ben Childers
Bill Kehoe
Pam Megna

FOLLOW-UP QUESTIONS

1. Provide sources and citations for the statistics cited in our ex parte.

The following citations are the source materials for two PowerPoint slides ("Substitutability with Wireless" and "Substitutability with Other Platforms") attached to Verizon's October 15, 2003 *ex parte* filed in this docket.

- Press Release, Federal Communications Commission, "Federal Communications Commission Releases Data on Local Telephone Competition" (rel. June 12, 2003) (numbers of ILEC, CLEC, cable telephony and wireless lines)
- Cellular Telecommunications & Internet Association Website (www.wow-com.com) accessed on Aug. 7, 2003 (number of U.S. mobile subscribers)
- Reuters Wire Service, "Wireless Use to Nearly Double by 2006," (Sept. 16, 2002) (citing Yankee Group) (wireless displacement minutes from wireline network)
- Pew Internet Project Data Memorandum (May 2003) (2003 market share data between cable, DSL, satellite & wireless)
- "2002 Syndicated Residential Internet Customer Satisfaction Study," J.D. Power & Assoc. (August 2002) (email and IM substitution statistics)
- FCC, Eighth Annual CMRS Competition Report, FCC 03-150 (rel. July 14, 2003) (911 calling patterns; percentage of subscribers who have cut the cord)
- Press Release, Federal Communications Commission, "Federal Communications Commission Releases Data on High-Speed Services for Internet Access," (June 10, 2003) (number of U.S. cable voice and data subscribers)
- Vik Grover & Richard Fetyko, "Initiation of Coverage: Verizon Communications, Inc.," Kaufman Bros., L.P. (July 14, 2003) (declining per minute pricing for wireless & second line substitution; incremental cost of cable telephony)
- Scott Ellison, "U.S. Wireless Displacement of Wireline Access Lines Forecast and Analysis, 2003-2007," IDC # 29969 (Aug. 2003) (primary and second line wireless displacement & survey data on wireless vs. wireline usage)
- "Wireless Competition" Slide attachment to October 15, 2003 ex parte (number of wireline vs. wireless subscribers; university revenue loss due to substitution)

2. What are the percentage discounts for our bundled offerings compared to the unbundled prices?

The discount percentages vary by state. The discounts also depend on an individual customer's circumstances. For example, for a plan that offers unlimited regional toll calling (e.g., Local Package Basic or Local Package Plus), a customer who previously had $30 in regional toll calling vs. a customer that had $5 in regional toll calling would experience significantly different "package discounts." Generally speaking, using average customer usage, our line packages offer discounts in the 5-20% range. If DSL is included in the package, a customer would get $5 off the regular price of $34.99 (or a 14% discount). If wireless is included, there is another $5 discount. The wireless discount is currently available in only five states (NY, NJ, PA, MA & VA).

3. **What is the percentage of customers that takes our bundled offerings vs. unbundled offerings in each state?**

The subscription rate for bundled service offerings is confidential due to its competitive sensitivity. Providing these data in the public record would give competing carriers information about the success of our pricing plans compared to theirs, which would give them a competitive advantage in determining which type of bundled offering is most attractive to customers. We would be at a competitive disadvantage, since we do not have similar information about the success of their pricing plans. However, we can say that while the majority of our customers at this point in time do not yet subscribe to bundled offers, the trend to purchase bundles is clearly increasing, as it is for all of our competitors (all of their Web sites promote package offers).

4. **How do we allocate the revenues for bundles among each of the services (local, long distance, etc.)? How does this comply with Section 251(c)(4)?**

Freedom is our only bundle that includes services from different Verizon affiliates. Revenues are assigned to the local exchange carrier according to the tariff rate for the underlying local package (e.g., Local Package Basic). Within the local exchange carrier, these revenues are further assigned to local, toll, and other services. The remainder of the revenues from the Freedom package are assigned to the long distance affiliate. Section 251(c)(4) is irrelevant, because the long distance affiliate does not resell local exchange service in the Freedom package. Rather, the local exchange carrier jointly markets its portion of the package under its tariff together with the long distance carrier's service pursuant to the long distance company's contracts or state tariffs. Both components are disclosed in the customer's bill.

5. **Are the unbundled rates tariffed at the state level?**

Yes. For our local exchange line packages (e.g., Local Package Standard or Local Package Basic), most of the underlying components are available on an a-la-carte basis (e.g., the dial tone line, unlimited local usage, features). The unlimited toll component is not available on a stand-alone basis. Similarly, the unlimited long distance component of Freedom is not available on a stand-alone basis (i.e., a customer must purchase the package to obtain the $15 unlimited long distance plan).

6. **How will the *Triennial Review Order* make it easier for IXCs to convert special access to UNEs?**

This is explained in the attached Joint Petition for Stay Pending Judicial Review, pp. 18-23 (filed Sept. 4, 2003).

7. **What is the percentage of the buildings that we serve that are also served by CLECs?**

It is very difficult to calculate market share based on the number of buildings served, since the CLECs do not share that information with us, and the data that they cite is not always comparable. "Buildings" can encompass a variety of structures, including single-family residential, multi-tenant residential, business office, industrial, etc. Not all commercial buildings have demand for special access services – some only require basic dial tone service. Consequently, different sources of data for the number of buildings served by CLECs (industry groups, government reports, carrier pronouncements...) yield varying data. Nonetheless, the percentage of buildings served by CLECs has been estimated to be as high as 45 percent. ***See** AT&T Petition for Rulemaking to Reform Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM 10593, Opposition of Verizon, Attachment, 1, 5 (filed Dec. 2, 2002). The data show that CLECs serve 330,000 buildings, including 30,000 entirely over their own fiber, out of 739,000 total commercial buildings (44.7 percent). The market impact of this penetration rate is even greater, because special access demand is highly concentrated in a small percentage of buildings. It has been estimated, for example, that 200 to 300 out of 15,000 multitenant units in a typical tier one metropolitan statistical area generate 80 percent of the data revenues. ***See*** id., 13. Time Warner Telecom, has recently stated, "while [BOCs] have a lot of fiber deployed, I don't know that they have more buildings connected than we do in all cases. In certain markets they may; in others they may not." *A Conversation with Time Warner Telecom's Mike Rouleau*, Telephony Online (Oct. 29, 2003), *at* http://telephonyonline.com/ar/telecom_conversation_time_warner/index.htm.

8. **How should the LECs account for the costs of providing long distance services on an unseparated basis?**

The Commission should continue to apply its current rules, which assign long distance costs to the "interexchange" category in Part 69, as it always has done for interstate interexchange services, such as "corridor" services. The carriers would continue imputing access charges to their interexchange services as they do today under the Commission's price cap rules. Long distance services should not be subject to the Cost Allocation Manual, because they would not be nonregulated services such as inside wire or enhanced services. Rather, they should be classified as non-dominant interexchange services.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)	CC Docket No. 01-338
	)	
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Deployment of Wireless Services Offering Advanced Telecommunications Capability	)	CC Docket No. 98-147

JOINT PETITION FOR STAY PENDING JUDICIAL REVIEW

Pursuant to 47 C.F.R. §§ 1.41, 1.43, BellSouth Telecommunications, Inc., Qwest Communications International Inc., SBC Communications Inc., the United States Telecom Association, and the Verizon telephone companies (collectively, "petitioners") jointly request the Commission to stay the specific portions of its recently released *Triennial Review* order that impose unbundling requirements with respect to elements of petitioners' traditional narrowband telephone networks.[1] For the reasons explained below, these requirements are fundamentally inconsistent with the terms of the Telecommunications Act of 1996 ("1996 Act" or "Act") and the previous directives of the Supreme Court and the D.C. Circuit, and will impede, rather than promote, the continuing development of meaningful competition. The requirements also will result in massive, immediate, and irreparable harm to petitioners and to the telecommunications

[1] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-338 *et al.*, FCC 03-36 (rel. Aug. 21, 2003) ("Order").

sector as a whole. They should be stayed pending review in a federal court of appeals pursuant to 47 U.S.C. § 402(a).

Because of the severe harm that will be caused by these rules if they are permitted to take effect, and to allow sufficient time for the reviewing court to address a stay motion in the event that the Commission does not grant relief, petitioners respectfully request action on this petition by September 11, 2003. If the Commission fails to resolve this petition by that date, petitioners will be constrained to seek relief in the court of appeals pursuant to Rule 18 of the Federal Rules of Appellate Procedure.

DISCUSSION

The challenged aspects of the Order should be stayed if petitioners demonstrate either (1) a likelihood of success on the merits together with a showing of "irreparable injury," or (2) a "serious" question regarding the merits coupled with a more "substantial" showing that the balance of equities tips in the movant's favor. *See Washington Metro. Area Transit Comm'n v. Holiday Tours, Inc.*, 559 F.2d 841, 844 (D.C. Cir. 1977). This petition meets both alternative standards, as petitioners are likely to succeed on the merits and the equities overwhelmingly favor a stay.

I. PETITIONERS ARE LIKELY TO SUCCEED ON THE MERITS

The Order is legally flawed on at least four distinct grounds, and petitioners are likely to succeed as to each.

A. The Order's Circuit Switching Requirements Are Unlawful

The undisputed evidence in the record demonstrated that competitive local exchange carriers ("CLECs") can and do use their own switches to serve millions of mass-market customers. The Order nevertheless requires incumbent LECs (or "ILECs") to provide CLECs with access to unbundled switching – and thus to the UNE-P – for each and every mass-market customer in the country. The Commission reaches this incongruous result by taking two steps: first, it makes a provisional finding of impairment based on alleged operational and economic issues associated with hot cuts; and, second, it delegates to the states – which were on record as supporting continuation of the UNE-P without limitation – the authority to make the ultimate determination as to whether CLECs are impaired without access to unbundled switching. Both steps are unlawful.

1. The Commission concludes that the need for a hot cut creates an "operational impairment" to the use of CLEC switches to serve mass-market customers. *See* Order ¶¶ 460, 464-469, 474. It bases this conclusion on the finding that "the record indicates that competitive LECs have self-deployed few local circuit switches to serve the mass market." *Id.* ¶ 438. That finding, in turn, is based solely on data relating to the number of *residential* lines served by CLEC switches. The Commission's analysis is thus admittedly incomplete. Indeed, the portion of the record it ignores makes clear that petitioners have performed well over a million hot cuts for mass-market business customers and have done so very successfully.[2] The Commission itself, moreover, has concluded pursuant to 47 U.S.C. § 271 that, in 42 states and the District of Columbia, the Bell company performs hot cuts at a level that gives CLECs a meaningful opportunity to compete *and* can meet reasonably foreseeable demand.

At bottom, then, the Commission's "operational impairment" finding is premised only on speculation – *i.e.*, that it is "unlikely" (Order ¶ 468) that ILECs could satisfy *increased* demand

[2] *E.g.*, Ex Parte Letter from Jim Lamoureux, SBC, to Marlene H. Dortch, FCC, CC Docket Nos. 01-338 *et al.* (FCC filed Feb. 5, 2003); Letter from Michael E. Glover and Susanne Guyer to William F. Maher, FCC (Jan. 10, 2003), attached to Ex Parte Letter from Ann D.

for hot cuts if the UNE-P were extinguished. Worse yet, the speculation on which the Commission bases its impairment finding is refuted by substantial record evidence that the Commission simply ignores. The record makes clear, for example, that petitioners' hot-cut performance has remained consistent even as volumes have increased.[3] It also shows that substantial increases in hot-cut volumes can be handled in many cases even without substantial additional ILEC resources, and that ILEC hot-cut processes are scalable.[4] In any event, even if these concerns were valid, the Commission could have addressed any hot-cut concern directly and in a tailored way – by, for example, requiring the incumbent to provide UNE-P on a line as a transitional matter unless and until it is able to perform the necessary hot cut, or as the Commission itself suggests with respect to the so-called "rolling" UNE-P. *See id.* ¶ 522.

The Commission's conclusion that the average cost of hot cuts, coupled with customer "churn," creates "economic impairment" nationwide is likewise unlawful. *Id.* ¶¶ 470-471. For one thing, hot-cut costs are set by state regulators and, as the Commission acknowledges, they

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Berkowitz, Verizon, to Marlene H. Dortch, FCC, at 5, CC Docket Nos. 01-338 *et al.* (Jan. 10, 2003) ("Glover/Guyer Letter").

[3] *See, e.g.*, Glover/Guyer Letter at 5-6 (explaining that Verizon had consistently provided more than 95% of hot cuts on time and without problems even when volumes skyrocketed in major states like Massachusetts, Pennsylvania, and New Jersey).

[4] *See* Declaration of John Berringer & David R. Smith ¶ 40, attached to Reply Comments of SBC Communications Inc., CC Docket Nos. 01-338 *et al.* (FCC filed July 17, 2002); Ex Parte Letter from Cronan O'Connell, Qwest, to Marlene H. Dortch, FCC, Attach. at 12, CC Docket Nos. 01-338 *et al.* (Dec. 18, 2002) (showing that Qwest had current capacity to meet 400% of current hot-cut demand, and could scale up even further); *see also, e.g.*, Memorandum Opinion and Order, *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, 15 FCC Rcd 3953, 4114, ¶ 308 (1999) ("[W]e . . . find that Bell Atlantic demonstrates that its ability to provision hot cuts is scalable such that the company can expand its capacity to perform hot cuts in response to increases in commercial demand."), *aff'd*, *AT&T Corp. v. FCC*, 220 F.3d 607 (D.C. Cir. 2000).

vary from state to state. *Id.* ¶ 470.[5] The Commission never reconciles its *national* finding of economic impairment with quantifiable, state-specific variations in hot-cut costs or its own conclusion that "a granular analysis must wherever possible account for market-specific factors." *Id.* ¶ 483.

In any event, the Commission's analysis of hot cuts and churn conflicts with *United States Telecom Association v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) ("*USTA*"), *cert. denied*, 123 S. Ct. 1571 (2003). There, the D.C. Circuit made clear that cost disparities in isolation, without regard to such things as potential revenues, CLEC cost advantages, and retail rate distortions, cannot justify impairment. *See id.* at 422-26. Likewise, the court emphasized that the Commission cannot count *every* sort of cost difference as impairment, regardless of whether it is simply a transient issue faced by new entrants in any market. *See*, *e.g.*, *id.* at 427 ("[t]o rely on cost disparities that are universal as between new entrants and incumbents in *any* industry is to invoke a concept too broad, even in support of an *initial* mandate, to be reasonably linked to the [Act's] purpose").

The Commission's nationwide finding that hot cuts create "economic impairment" runs afoul of both mandates. The Commission made no attempt to view hot-cut costs in the larger context that the D.C. Circuit required; rather, it found them to be a source of economic impairment based solely on the self-serving allegations of a handful of CLECs that claimed they were experiencing high churn rates. But churn rates cannot, in and of themselves, create impairment. There may be many reasons why a CLEC experiences high churn, and many things

[5] Indeed, WorldCom's own evidence showed that the average cost of a hot cut in California is $19, far less than the average on which the Commission bases its analysis. *See* Letter from Ruth E. Holder, Lawler, Metzger & Milkman, LLC, to Marlene H. Dortch, FCC, CC Docket Nos. 01-338 *et al.* (Feb. 12, 2003).

a CLEC can do about it. Indeed, churn is just another name for competition, as customer retention reflects a carrier's ability to compete in the marketplace. In any event, as the Commission recognizes, any concern about churn can be addressed directly through measures such as a 90-day rolling cut-over, which would cut churn costs in half. *See* Order ¶¶ 523-524. In short, the Commission did not demonstrate that, when considered in light of CLEC cost advantages and other relevant factors, churn and hot-cut costs prevent entry. Nor did it reconcile its finding of economic impairment with the more than one million mass-market customer lines that have already been transferred to CLECs via the hot-cut process. Rather, the Commission fell back on the false assertion that, because hot cuts and churn create *some* level of cost disparity for CLECs at the outset of entry, CLECs must be impaired. *See id.* ¶ 470. Under *USTA*, that isolated assertion is insufficient as a matter of law to justify unbundling.

Because the Commission's provisional conclusion that the hot cut process creates impairment is indefensible, so too is the Commission's failure to consider properly the hundreds of CLEC switches that have been deployed and are being used today to serve millions of enterprise customers. There is no reason those switches cannot readily be used to serve mass market customers, even if they are not so used today. The Commission erred by ignoring them.

2. The Commission's decision to delegate the ultimate unbundling determination to the states is likewise unlawful.

First, the 1996 Act does not permit the Commission to delegate unbundling decisions to the states. Congress required that "*the Commission* shall consider" "impair[ment]" in "*determining*" which network elements to make available, 47 U.S.C. § 251(d)(2) (emphases added), and further provided that "*the Commission* shall complete all actions necessary to establish regulations to implement the requirements of this section" – including the unbundling requirements of that section – within six months after the Act's enactment, *id.* § 251(d)(1) (emphasis added). Any effort to delegate this decisionmaking authority necessarily "subvert[s] the plain meaning of the statute, making its mandatory language merely permissive." *Miller v. French*, 530 U.S. 327, 337 (2000).

Second, any lawful delegation obviously would have to establish meaningful constraining standards that ensure that these state decisions comport with the Act as interpreted in *USTA* and *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999). The Commission's "standards" for its delegation fail that basic test.

As an initial matter, the Commission's claim that the first part of its test is an "objective" one that relies on the states only for "fact-finding," Order ¶¶ 493, 498, is incorrect. In fact, although the test requires states to determine whether there are three switch-based competitors in "the market," the Commission left it to the states to decide the generally dispositive question of what constitutes the relevant geographic market. *Id.* ¶¶ 495-496; *see also id.* ¶ 497 (giving the states similar authority to decide what constitutes the "mass market" product market). Furthermore, as discussed in more detail below, the Commission gave the states broad latitude to determine which competitive switches count toward the triggers. In view of the discretion vested in the states in these matters, the suggestion that the first prong of the Commission's test establishes firm criteria to rein in unbundling is implausible.

The second part of the Commission's test likewise fails to impose any meaningful constraint on the states' discretion that would ensure that unbundling is limited in the manner contemplated by the Act and compelled by *USTA*. Indeed, in this aspect of the test, the Commission has not even provided the states with a rule of decision. Instead, the states are to examine a collection of factors, application of each of which will require the states to exercise considerable discretion, all without binding guidance from the Commission. *E.g.*, *id.* ¶¶ 517, 520. The Commission has not provided the guidance necessary to ensure that these issues are resolved consistently across the country in a manner that comports with the 1996 Act and judicial precedent. Thus, although the ultimate decisionmaker differs from the framework previously found unlawful by the D.C. Circuit, the end result of the Commission's test – *i.e.*, the absence of any meaningful limiting principle, and the resulting requirement to unbundle in the absence of impairment related to natural monopoly characteristics – is the same.

Furthermore, to the extent that the FCC test *does* guide the states, it does so in ways that are affirmatively inconsistent with the 1996 Act. Most dramatically, under the "objective" prong of the test, incumbents may obtain relief only where each of three competitors is "operationally ready and *willing* to provide service to *all* customers in the designated market." *Id.* ¶ 499 (emphases added). The second part of the FCC test includes a similar rule. *Id.* ¶ 519 ("State commissions must ensure that a facilities-based competitor could economically serve all customers in the market before finding no impairment.").

As *USTA* makes clear, however, there are many reasons other than impairment that may dissuade a facilities-based carrier from being "ready and willing" to serve *all* customers in the designated market. CLECs may, for example, rationally avoid the segment of the market where the incumbent's retail rates are set below cost. *See* 290 F.3d at 422 ("[o]ne reason for . . . market-specific variations in competitive impairment is the cross-subsidization often ordered by state regulatory commissions" that "brings about undercharges for some subscribers"). In *USTA*, the D.C. Circuit emphasized precisely this point, criticizing the Commission's *UNE Remand*

Order[6] for failing to "address[] by what criteria want of unbundling" can be said to cause impairment in markets "where customers are already charged below cost." *Id.* The Commission's "all customers in the market" standard suffers from the same flaw.

Similarly, this standard ignores a second and independent holding in *USTA*: that the Commission must "consider[] the advantage CLECs enjoy in being free of any duty" to serve all customers in the market. *Id.* at 423. Even apart from universal-service distortions, CLECs can – and, indeed, the rational ones do – serve specific segments of the market, most notably the high-volume, high-revenue customers who present the most potential profit. The ability to engage in cherry-picking is one of the key competitive edges that CLECs have. The Commission's delegated "standard," however, turns this CLEC advantage on its head. It indicates that CLECs that follow such a rational strategy do *not* count for purposes of determining whether a market is competitive and thus whether CLECs are entitled to access to unbundled switching.

Indeed, the Commission's "all customers in the market" standard may well preclude consideration of existing intermodal competitors such as cable providers (which generally provide service only where they own cable facilities) and rapidly growing voice-over-Internet-protocol companies (which provide service only to customers with computers and broadband connections). In fact, despite the D.C. Circuit's express directive to consider intermodal competition, the Commission specifically discounts competition from cable companies – which already offer local telephone service to more than 10 million homes – because they do not offer a wholesale platform to other competitors. *See* Order ¶¶ 443, 446. Likewise, while the

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[6] Third Report and Order and Fourth Further Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 3696 (1999) ("*UNE Remand Order*"), *petitions for review granted and remanded*,

Commission holds that commercial mobile radio service ("CMRS") providers compete against ILEC local voice service and thereby qualify for UNEs, *see id.* ¶ 140, it nevertheless holds that their switches are *not* substitutes for ILEC switches, and thus do *not* count for purposes of the objective trigger, for the same reason, *see id.* ¶ 499 & n.1549; *see also id.* ¶¶ 445-446. The Act is concerned with ensuring that markets are open to *competition*, not with ensuring that individual *competitors* have an enduring wholesale supplier. The Commission's disregard of this principle exhibits "naked disregard of the competitive context," rendering its rules inconsistent with *USTA* and contrary to the Act. *See* 290 F.3d at 429.

Moreover, the Commission's standard for determining when a market is sufficiently competitive to preclude a finding of impairment – in particular, the existence of three competitors (plus the ILEC) serving all mass-market customers in the market in question – compounds these problems. *See* Order ¶ 501. Under the Act and *USTA*, the dispositive question is not whether, at any given moment, a particular market is characterized by multiple, facilities-based competitors. Rather, the Act requires that impairment determinations be based on the "ability" of a competitor to enter, 47 U.S.C. § 251(d)(2)(B), or, as the court put it, whether the market is "[]suitable" for facilities-based competition. *USTA*, 290 F.3d at 427. It takes far fewer than *four* facilities-based providers to establish that multiple competitive supply is feasible and thus that unbundling is not permissible. Telecommunications is a capital-intensive, high fixed-cost business, in which there are unlikely to be *four* facilities-based competitors fighting for the same mass-market customers in many geographic markets. Yet, under the Commission's rule, any market that does not meet that standard is presumptively not susceptible to competition and

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United States Telecom Ass'n v. FCC, 290 F.3d 415 (D.C. Cir. 2002), *cert. denied*, 123 S. Ct. 1571 (2003).

therefore subject to additional analysis as to whether the impairment standard is met. By contrast, the D.C. Circuit threw out the Commission's line-sharing rules because the existence of extensive facilities-based competition from cable demonstrated that competition could flourish without unbundling and thus rendered those rules contrary to the Act. *See id.* at 428 (stressing "competition in broadband services coming from cable (and to a lesser extent satellite)"). Similarly, the Commission long ago declared the long-distance market to be competitive on the basis of the *potential* for competitors to compete with the incumbent throughout its markets. *See* Order, *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, 3304, ¶ 60 (1995).

Finally, the Commission's failure to retain review authority over state unbundling decisions renders its delegation triply unlawful. Even where a federal agency is permitted to delegate decisionmaking authority granted by Congress, federal law requires that the agency not "relinquish . . . the final authority" to make the relevant decision; instead, that decision must ultimately be approved by the agency in question. *Southern Pac. Transp. Co. v. Watt*, 700 F.2d 550, 556 (9th Cir. 1983). Indeed, all the cases that the Commission cites on this issue (Order ¶ 188 n.604) make this very point. *See, e.g.*, *Vierra v. Rubin*, 915 F.2d 1372, 1379 (9th Cir. 1990) ("for a state to receive federal funds under the AFDC program, *the state must submit to the Secretary, and have the Secretary approve*," the relevant plan) (emphasis added); *see also* Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8987, ¶ 396 & n.1022 (1997) (delegating authority to state commissions to grant waivers of its "no-disconnect" rule for Lifeline customers, but providing for direct appeal to the FCC of any such decision). Under the Order, however, the Commission has no obligation to review the 51 separate state findings, either before or after they take effect approximately nine months from now. That failure confirms the unlawfulness of the Commission's delegation here.

B. The Order's Transport, High-Capacity Loops, and Dark Fiber Unbundling Requirements Are Likewise Unlawful

For many of the same reasons, the Order's unbundling requirements with respect to high-capacity loops and dedicated transport – including dark fiber – are also unlawful. Here too the Commission adopted nationwide findings of impairment that have no basis in the record, and, here too, the Commission delegated the ultimate unbundling determination to the states. Again, both steps are unlawful.

1. In *USTA*, the D.C. Circuit pointed specifically to the *UNE Remand Order*'s finding that, as of 1999, "47 of the top 50 areas ha[d] 3 or more competitors providing interoffice transport," and it admonished the Commission for failing to "explain[] why the record supports a finding of material impairment where the element in question – though not literally ubiquitous – is significantly deployed on a competitive basis." 290 F.3d at 422. The undisputed record before the Commission demonstrated that high-capacity loops, dedicated transport, and dark fiber are now even *more* "significantly deployed on a competitive basis." Indeed, as of year-end 2001, *49* of the top 50 areas had *five* or more competitors self-providing transport.[7] The Commission itself acknowledges that competitors have deployed at least 184,000 miles of fiber, and perhaps as much as 339,500 miles, the bulk of which is in "densely populated areas" where it is "significantly" *more* expensive to deploy facilities. Order ¶¶ 371, 378. The record also demonstrated, moreover, that CLECs had entered the market and were competing successfully

[7] *See UNE Fact Report 2002*, App. K, *attached to* Comments of SBC Communications Inc., CC Docket Nos. 01-338 *et al.* (Apr. 5, 2002) ("*UNE Fact Report 2002*").

using wholesale special access services – rather than UNEs – to meet their high-capacity transmission needs.[8]

Just as it did in the *UNE Remand Order*, however, the Commission "find[s] on a national basis" that competitors are impaired without access to high-capacity loops and dedicated transport, and it accordingly requires unbundling throughout the country. *See id.* ¶¶ 311, 381 (dark fiber loops and transport); *id.* ¶¶ 320, 386 (DS3 loops and transport); *id.* ¶¶ 325, 390 (DS1 loops and transport). The Commission's rationale in this respect is that, even though "competitive [facilities] ha[ve] been deployed in many areas," "the record lacks the specificity" to permit the Commission "to analyze appropriately [these facilities] on a *route-specific* basis." *Id.* ¶ 392 (emphasis added); *see id.* ¶¶ 314, 321, 384, 387. The Commission thus orders unbundling of these facilities *everywhere*, subject to a location-specific analysis to be conducted by state commissions.

Even if a route-specific analysis were appropriate – which, as we explain below, it is not – the Commission's analysis here gets things exactly backwards. Under the 1996 Act, the Commission must make a finding of impairment with respect to an element *before* it orders unbundling of that element. *See, e.g.*, 47 U.S.C. § 251(d)(2) (Commission "shall" consider the "impair[ment]" standard "[i]n determining what network elements should be" unbundled); *Supplemental Order Clarification*,[9] 15 FCC Rcd at 9596, ¶ 16 (Commission must determine

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[8] *See UNE Rebuttal Report 2002* at 7-8, 44-46, *attached to* Ex Parte Letter from Dee May, Verizon, to Marlene H. Dortch, FCC, CC Docket Nos. 01-338 *et al.* (Oct. 23, 2002); Ex Parte Letter from W. Scott Randolph, Verizon, to Marlene H. Dortch, FCC, CC Docket Nos. 01-338 *et al.* (Jan. 10, 2003).

[9] Supplemental Order Clarification, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 9587 (2000) ("*Supplemental Order Clarification*"), *petitions for review denied*, *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8 (D.C. Cir. 2002).

"impairment" "before imposing additional unbundling obligations on incumbent LECs" rather than "impos[ing] such obligations first and conduct[ing] our 'impair' inquiry afterwards"). Simply put, if the Commission is unable to determine where, if anywhere, competitors are impaired without access to a particular network element, the answer is not to unbundle it *everywhere*. Quite the contrary, under the express terms of the Act, the Commission may impose an unbundling obligation only where it makes a determination, based on substantial record evidence, of impairment in a particular market – which the Commission concedes does not exist. *See United Scenic Artists, Local 829 v. NLRB*, 762 F.2d 1027, 1034 (D.C. Cir. 1985) (agency "is not free to ignore statutory language by creating a presumption on grounds of policy to avoid the necessity for finding that which the legislature requires to be found").

The Commission's "unbundle first, ask questions later" approach is particularly inappropriate in view of the fact that it is the *CLECs* that know specifically where they have deployed the facilities that would meet the Commission's triggers. By presuming impairment – and then leaving it to the ILECs to *dis*prove it before the state commissions – the Commission has effectively shifted the burden of proving impairment *away* from the parties that have within their control the very information the Commission claims to need to conduct the inquiry properly. That arbitrary step further undermines the legitimacy of the Commission's so-called "national findings" here.

2. The Commission cannot cure these deficiencies by delegating to the states the authority to reverse its nationwide impairment findings based on location-specific analyses. As with its delegation of switching, the Commission's attempt to assign to the states the ultimate unbundling determination – with no obligation on the part of the Commission to review those determinations – is contrary to the language and structure of the statute and is accordingly unlawful.

Apart from this threshold failing, moreover, the Commission's delegation on loops and transport – like its delegation on switching – fails to provide any meaningful limiting standards to ensure that the state decisions are consistent with the Act and judicial precedent.

First, the Commission's competitive "trigger" analysis focuses only on *specific* locations – *i.e.*, particular point-to-point routes in the case of transport, and particular premises in the case of loops. In *USTA*, however, the D.C. Circuit specifically directed the Commission to *infer*, based on the evidence of competitive deployment, the characteristics of markets where, even if CLECs have not yet deployed their own facilities, they could. *See* 290 F.3d at 422. By focusing on the purported absence of location-specific evidence, the Commission willfully declines to draw any such inference. Instead, the Commission's trigger analysis reflects the belief that, if alternative suppliers have not yet arrived on a particular route, CLECs may be impaired without access to facilities on that particular route. The FCC "is not free to prescribe what inferences from the evidence it will accept and reject, but must draw all those inferences that the evidence fairly demands." *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 378 (1998); *see Warshawsky & Co. v. NLRB*, 182 F.3d 948, 953 (D.C. Cir. 1999) (same). Here, the Commission failed to draw any inference at all, much less the inferences "fairly demand[ed]" from the extensive and undisputed evidence of competitive deployment.

The Commission's failing here is particularly striking in light of the fact that, in analogous circumstances, the Commission has drawn precisely the sort of inferences that are appropriate in this context. In the *Special Access Pricing Flexibility* proceeding, the Commission permitted ILECs special access pricing flexibility in markets that the Commission concluded were disciplined by competition. The Commission conducted this inquiry not on a route-by-route basis, but rather across metropolitan statistical areas ("MSAs"). MSAs, the Commission explained, "best reflect the scope of competitive entry," and more narrowly defined markets would be "administratively [un]workable." Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 14 FCC Rcd 14221, 14259-60, ¶¶ 71-72 (1999), *aff'd*, *WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001). That rationale – which the D.C. Circuit expressly affirmed, *see WorldCom*, 238 F.3d at 461 – applies equally here.

The Commission's defense of this inconsistency is strikingly contrary to the 1996 Act's language, structure, and purpose. In the Commission's view, the pricing flexibility rules "go to protecting consumers from anticompetitive pricing," whereas the unbundling rules "serv[e] a host of [other] statutory goals." Order ¶ 104. In other words, "competition in some parts of a market may be sufficient to constrain prices, but insufficient to demonstrate a lack of impairment." *Id.* But, if a market is already competitive enough to restrain prices, the social costs that come with forced sharing outweigh, as a matter of law, any countervailing benefits. As the D.C. Circuit held, the Act *forecloses* unbundling in the absence of a "reason to think doing so would bring on a significant enhancement of competition." *USTA*, 290 F.3d at 429. Where there is sufficient "competition in some parts of a market . . . to constrain prices" throughout the market, Order ¶ 104, it is clear that there is no "significant enhancement of competition" to be had. It follows that, in such circumstances, "nothing in the Act" gives the Commission "license . . . to inflict on the economy the sort of costs" associated with unbundling. *USTA*, 290 F.3d at 429.

Second, the Commission's location-specific analysis fails even on its own terms. As with switching, the Commission's "objective" trigger permits unbundling even where *multiple* competitors serve specific locations using their own facilities. Thus, for example, even where a CLEC has self-deployed its own facilities on a particular route, another CLEC would be entitled to unbundled access to the ILEC's facilities on that same route. *See* Order ¶ 407. Unbundling of a high-capacity loop would be permitted in similar circumstances, despite the fact that even the largest business customers would have little reason to buy high-capacity circuits from more than two suppliers (which would provide diversity), and frequently will buy circuits to a particular location from only one among the competitive alternatives. *See id.* ¶ 329. It is impossible to see how the Commission (or a state) could lawfully order unbundling on such specific locations, where the existence of such competitive deployment demonstrates conclusively that the facility is subject to competitive supply. *See USTA*, 290 F.3d at 422. Yet the Commission's standards permit exactly that result.

Finally, the "analytical flexibility" (Order ¶ 410) the Commission grants to the states fails to cure these failings. The Commission permits the states to "find no impairment on a particular route that it finds is suitable for 'multiple, competitive supply,' but along which [the relevant] trigger is not facially satisfied." *Id.*; *see id.* ¶ 335. Such determinations are to be based on a mix of factors, ranging from "local engineering costs" to "the cost of equipment needed for transmission"; from "local topography such as hills and rivers" to "the availability or feasibility" of unspecified "alternative transmission technologies." *Id.* ¶ 410; *see id.* ¶ 335. But, as with switching, the Commission fails to provide clear standards as to how the states are to weigh these factors, nor does it suggest a rule of decision to ensure that the ultimate unbundling determination will be consistent with *USTA* and Congress's core goal of enhancing facilities-based competition. Indeed, the Commission itself concedes as much. It candidly explains that, far from compelling states to make determinations that will faithfully adhere to the direction given by the statute and the courts, the Order "provides no guidance on how these various factors are to be assessed and weighed." *Id.* ¶ 425 n.1300. Such a standardless delegation plainly fails to fill the gap left by the Commission's failure to determine the characteristics of markets that are suitable for competitive supply, and equally plainly leaves in place the prospect of overly expansive unbundling in conflict with the Act and judicial precedent.[10]

C. The Order's Evisceration of the Restrictions on EELs Is Arbitrary and Capricious and Contrary to Precedent

The Commission's expansive rulings on loops and transport are exacerbated by its dramatic undoing of the restrictions that apply to the use of enhanced extended links, or "EELs."

As the D.C. Circuit has explained, an EEL can be useful not just for the provision of local service, but also for *non*local services – in particular, for the origination and termination of long-distance calls to high-volume customers, or "special access." *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8, 11 (D.C. Cir. 2002) ("*CompTel*"); *see WorldCom*, 238 F.3d at 453. Until this Order, however, the Commission sought to "channel CLECs' use of EELs toward local service" and to prevent their use for special access. *CompTel*, 309 F.3d at 11; *see Supplemental Order*,[11] 15 FCC Rcd at 1760, ¶ 2; *Supplemental Order Clarification*, 15 FCC Rcd at 9598-600, ¶ 22. The reason it did so was plain. No party demonstrated impairment with respect to nonlocal

[10] The concerns resulting from the Commission's pervasive loop and transport unbundling rules are compounded by the unlawful requirement – set out for the first time in the Order – that ILECs deploy new equipment (such as multiplexers and the like) solely for the purpose of unbundling it at TELRIC prices. *See* Order ¶ 635; *compare Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 812-13 (8th Cir. 1997) (the 1996 Act "requires unbundled access only to an incumbent LEC's *existing* network – not to a yet unbuilt superior one"), *aff'd in part, rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

[11] Supplemental Order, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 1760 (1999) ("*Supplemental Order*"), *petitions for review denied, Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8 (D.C. Cir. 2002).

services, and, in the absence of such a showing, the EEL could not, consistent with the Act, be unbundled for use in providing such services. *See CompTel*, 309 F.3d at 14 ("[I]t is far from obvious . . . that the FCC has the power, without an impairment finding as to nonlocal services, to require that ILECs provide EELs for such services on an unbundled basis.").

The mechanisms by which the Commission achieved this limitation – which the D.C. Circuit specifically upheld in *CompTel* – are significant. Recognizing that the only use of an EEL that could be justified under the 1996 Act was to provide *local* service, the Commission required that CLECs do exactly that. It insisted that EELs be available only to carriers that would use the facility to provide "a *significant* amount of local exchange service." *Supplemental Order Clarification*, 15 FCC Rcd at 9598-600, ¶ 22 (emphasis added). And it put teeth in that standard by establishing objective criteria to ensure that the EEL would actually be used as a legitimate portion of a local service offering, and by prohibiting "commingling" of UNEs (such as loops) with special access services (such as special access transport) in order to prevent widespread evasion of those objective criteria. *Id.* at 9598-600, ¶ 22, 9602, ¶ 28; *see CompTel*, 309 F.3d at 17-18.

The Order eviscerates these requirements. Most dramatically, whereas previously the Commission required the facility in question to provide a "significant" amount of local service, now it need provide only a *de minimis* amount, if anything at all. Under the Commission's new test, a facility used predominantly if not exclusively to provide *non*local services – in markets in which there is no claim, much less a finding, of impairment – is nevertheless subject to unbundling.

Nothing in the Commission's new requirements protects against that unlawful result. *See* Order ¶¶ 601-611. The first three requirements – state certification, local number assignment, and an E911 record – establish only that a competitor *could* use the EEL to provide local service, not that it actually does so. Thus, for example, state certification – which the major long-distance incumbents (which are the chief purchasers of special access and thus the chief beneficiaries of the new rules) have already obtained in virtually every state – is a necessary prerequisite to providing local service, but it does not require that the carrier actually do so, much less that it use any particular circuit for that purpose.[12] Likewise, the Order's insistence that each DS1 circuit (or its equivalent) be assigned a local telephone number establishes only that some portion of a circuit *might* be capable of providing local service; it again says nothing about how it actually *is* used.[13] And the E911 record similarly is something that rests entirely within the competitor's discretion and need not necessarily correlate in any way with the actual provision of local service.[14]

The Commission's next two requirements – which require that the facility terminate to a collocation arrangement, with a switch that could in theory provide local service – are equally meaningless. As to the requirement that EELs terminate to a carrier's collocation arrangement, the major long-distance incumbents already have nearly ubiquitous collocation arrangements, and they accordingly already terminate a significant portion of special access circuits to collocation arrangements and could readily reconfigure the rest to do so.[15] And, as to the

[12] *See* Ex Parte Letter from Ann D. Berkowitz, Verizon, to Marlene H. Dortch, FCC, Attach. at 2, CC Docket Nos. 01-338 *et al.* (Feb. 6, 2003) ("Verizon Feb. 6 Ex Parte"); *see also* Ex Parte Letter from Ann D. Berkowitz, Verizon, to Marlene H. Dortch, FCC, Attach. at 7, CC Docket Nos. 01-338 *et al.* (Jan. 30, 2003) ("Verizon Jan. 30 Ex Parte").

[13] *See* Verizon Jan. 30 Ex Parte, Attach. at 7.

[14] *See id.*

[15] *See id.* Indeed, fully 90% of the special access services purchased by Verizon's two largest special access customers already terminate in offices with collocation. *See* Verizon Feb. 6 Ex Parte, Attach. at 2.

requirement that EELs terminate to a switch that is *capable* of providing local service, the Commission itself appears to recognize that CLECs, including the major long-distance carriers, have already deployed switches that can be used for this purpose in essentially every major market. *See* Order ¶ 436.[16]

Finally, the last requirement – that each DS1 (or equivalent) be associated with a *single* interconnection trunk – permits the tail to wag the dog. This part of the test simply requires that there be a single interconnection trunk in the same LATA for every 24 circuits in a particular EEL arrangement. Here again, however, the long-distance incumbents have *already* satisfied this goal in the main, with interconnection trunks with available capacity in most LATAs ready to be associated with an EEL.[17] Moreover, in the most common configuration – a D3 EEL with a single DS1 interconnection trunk – even if that interconnection trunk actually does carry only local traffic (as opposed to, say, Internet-bound traffic), the amount of local traffic carried on the entire facility, relative to the nonlocal traffic, would be minimal.[18] Yet, in these circumstances, the competitor would still be entitled to the facility on an unbundled basis.

In short, the Order places the Commission squarely where the D.C. Circuit said it could not go. It broadly permits the use of EELs to provide special access, with *no* practical limitation on the extent to which they can do so. And it does this in the absence of any suggestion – much

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[16] *See also UNE Fact Report 2002* at II-1, II-2 (noting that the two largest long-distance carriers account for more than 25% of CLEC local switches).

[17] *See generally* Verizon Feb. 6 Ex Parte, Attach. at 2; Verizon Jan. 30 Ex Parte, Attach. at 7.

[18] *See* Ex Parte Letter from Dee May, Verizon, to Marlene H. Dortch, FCC, Attach. at 3-4, CC Docket Nos. 01-338 *et al.* (Feb. 12, 2003).

less a finding – that competing carriers are impaired in their ability to provide special access without access to UNEs.[19]

This unlawful result is compounded, moreover, by the Commission's abandonment of the restriction on commingling. Before the D.C. Circuit, the Commission took the position that this restriction "is the only way to prevent carriers from using [EELs] 'solely or primarily to bypass special access services.'" *CompTel*, 309 F.3d at 17 (quoting *Supplemental Order Clarification*, 15 FCC Rcd at 9602, ¶ 28). That was so because the Commission had *not* placed local use restrictions on unbundled loops, and, without such restrictions, commingling would permit competitors to convert "the entire base of the loop or 'channel termination' portion of special access circuits . . . into unbundled loops." *Id.*

That concern remains equally valid today. To be sure, the Commission requires that unbundled loops satisfy the new requirements when commingled with special access services. Order, App. B at 6 (new rule 51.318(b)). But, for the reasons explained above, those requirements do not in fact impose any meaningful local usage obligation. As a result, as was the case previously, in the absence of a "restriction against commingling," carriers will be permitted to use UNEs to provide special access on a widespread basis, in direct conflict with the purposes of the 1996 Act. *See CompTel*, 309 F.3d at 17.

Finally, the Commission's broad allowance of "conversions" – *i.e.*, the reclassification of special access services as UNEs, without any change in the underlying facility or the service to

[19] The Commission suggests that these requirements are "based largely on . . . solutions advanced by" certain of the petitioners here. Order ¶ 596. Although the solutions advanced by petitioners did include *some* of the requirements articulated by the Commission, they also contained *additional* requirements that would have meaningfully limited the ability of competing carriers to use EELs to displace special access service. The Commission rejected these additional requirements, thus eliminating the effectiveness of the new rules.

which it is put – is likewise unlawful. By definition, a "conversion" can occur only if the requesting carrier already is using special access services to provide the services that it seeks to offer; otherwise, there would be nothing to convert. And, if a carrier already is using special access services to provide the services that it seeks to offer, it cannot be said that it requires UNEs in order to offer those services. Indeed, the only effect of a conversion would be to give that carrier a price break – and hence higher profits – for a service that it already is providing. But, as the Supreme Court made clear in *Iowa Utilities Board*, the impairment standard is not satisfied simply because unbundled access would permit competitors to reduce their costs and earn higher profits. The Order's allowance of special access conversions generally is thus inconsistent with the Act.

D. The Order Unlawfully Permits CMRS Providers To Use UNEs for Interoffice Transmission Between Cell Sites and Mobile Switching Centers and Between Mobile Switching Centers and IXCs' Points of Presence

In the *Line Sharing Order*,[20] the Commission required ILECs to provided unbundled access to the high-frequency portion of the loop, to facilitate CLEC provision of broadband services. It did so, however, with a "naked disregard of the competitive context" – which featured multiple, facilities-based providers competing without any access to (or need for) one another's facilities – thus rendering the line-sharing rules unlawful. *USTA*, 290 F.3d at 429.

The Order makes a similar mistake here, only this time in a different market. The Order makes clear that facilities between cell sites or mobile switching centers ("MSCs") and ILEC central offices are not eligible for UNE treatment. *See* Order ¶ 368. Then, however, in the very

[20] Third Report and Order in CC Docket No. 98-147 and Fourth Report and Order in CC Docket No. 96-98, *Deployment of Wireline Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications*

same paragraph, the Commission expressly permits CMRS providers to gain access to ILEC interoffice transmission facilities on an unbundled basis, even when this could allow CMRS providers to connect their MSCs to their cell sites or to interexchange carrier ("IXC") points of presence ("POPs") through the use of ILEC transport when the ILEC network would otherwise have nothing do with that connection. The Commission imposes this new requirement, moreover, without so much as hinting that CMRS providers are in any way impaired without access to these facilities. Rather, the Commission simply concludes that, because CMRS providers compete with ILECs in a "core" market – *i.e.*, wireline voice, *see id.* ¶ 139 – and because the economics of self-deployment for *wireline* competitors purportedly establish impairment with respect to interoffice transport, *see, e.g., id.* ¶¶ 370-372 – CMRS providers are entitled to interoffice transmission at TELRIC rates.

That analysis is patently inconsistent and untenable. Wireless carrier competition clearly has not been impaired by the unavailability of unbundled dedicated transport to carry calls between their MSCs and cell sites or between their MSCs and IXC POPs. To the contrary, CMRS providers have used their own facilities or special access services to accomplish that end, and they have done so quite successfully. Indeed, the Commission's own most recent report on competition in the CMRS market confirms that "the CMRS industry continue[s] to experience increased service availability, lower prices for consumers, innovation, and a wider variety of service offerings"[21] – all without the availability of dedicated transport at TELRIC rates.

Act of 1996, 14 FCC Rcd 20912 (1999) ("*Line Sharing Order*"), *vacated and remanded*, *USTA v. FCC*, 290 F.3d 415 (D.C. Cir. 2002), *cert. denied*, 123 S. Ct. 1571 (2003).

[21] Eighth Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, WT Docket No. 02-379, FCC 03-150, ¶ 17 (rel. July 14,

The Order acknowledges this basic, incontrovertible fact, *see, e.g., id.* ¶ 53 ("[w]ireless telephone subscriber growth for the mass market has been remarkable"), yet it wholly fails to explain how the introduction of UNEs into this vibrantly competitive market could be thought to further the goals of the Act. The Order thus exhibits the same "naked disregard of the competitive context" that infected the Commission's prior line-sharing rules, and the resulting rules are accordingly equally unlawful.

II. THE BALANCE OF EQUITIES FAVORS A STAY

The Commission's previous efforts to impose maximum unbundling have caused petitioners substantial and irreparable injury. As petitioners documented in their recent petition for mandamus, they lose thousands of lines *every day* to the purely synthetic competition spawned by the Commission's unbundling rules.[22] For each such line lost, moreover, petitioners lose 60% of the revenues on that line, while retaining 95% of the costs.[23]

A stay is necessary to prevent these losses from mounting. In the wake of the Order, CLECs have announced their intention to adopt UNE-P as their entry strategy of choice.[24]

2003). *See also* Report and Order, *2000 Biennial Regulatory Review, Spectrum Aggregation Limits For Commercial Mobile Radio Services*, 16 FCC Rcd 22668 (2001).

[22] *See* Affidavit of Jimmy Glenn McGuire, Attach. 1 to USTA *et al.* Petition for a Writ of Mandamus To Enforce the Mandate of this Court, *United States Telecom Ass'n v. FCC*, Nos. 00-1012 *et al.* (D.C. Cir. filed Aug. 28, 2003) ("USTA Mandamus Pet."); Affidavit of William M. Campbell, Attach. 2 to USTA Mandamus Pet.; Declaration of Guy L. Cochran, Attach. 3 to USTA Mandamus Pet.

[23] *See* J.P. Morgan Securities Inc., *Industry Update – No Growth Expected for Bells in 2003*, at 15 (July 12, 2002).

[24] *See,e. g.*, Sprint Press Release, *Sprint Moves Forward with Portfolio of Local, Long-distance and Nationwide Wireless Bundles; FCC UNE-P Order Encourages Expansion of Successful Sprint Trials* (Aug. 27, 2003) (Sprint's Complete Sense bundled offering "is in direct response to the recent FCC order on UNE-P"); *Through the Fire*, Wireless Week, Mar. 8, 2003, at 18 ("If we get a favorable [UNE-P] ruling that says let the states decide and it lasts for a couple of more years, then we want to aggressively offer UNE-P to our 15 million Sprint

Plainly, the additional customer losses that would result from even more widespread use of the UNE-P – which would stem not from competition on the merits but rather from the regulatory arbitrage permitted by the FCC's expansive unbundling rules – establish irreparable injury. *See, e.g.*, *Multi-Channel TV Cable Co. v. Charlottesville Quality Cable Operating Co.*, 22 F.3d 546, 552 (4th Cir. 1994). And the staggering financial losses that go hand-in-hand with these customer losses bolster that showing. *See Wisconsin Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985) (per curiam) (suggesting that, in the absence of "adequate compensatory or other corrective relief," "economic loss" amounts to irreparable harm) (citation and internal quotation marks omitted); *cf. Independent Bankers Ass'n of Am. v. Smith*, 534 F.2d 921, 929-30, 951-52 (D.C. Cir. 1976) (losses that stem from "competitive disadvantages" based on unfair competition constitute irreparable injury).

It is no answer to contend that the 51 state proceedings contemplated by the Order provide petitioners an opportunity to avoid these losses. "Litigation in scores of cases is not an adequate remedy for an agency's failure to carry out its statutory duties." *American Trucking Ass'ns, Inc. v. ICC*, 669 F.2d 957, 961 (5th Cir. 1982) (per curiam). Moreover, even apart from the fact that many state commissions have already announced their intention to retain the UNE-P, the Order permits them to eliminate it only after nine months of wrangling in the states, followed by a "transition" period that requires continued unbundling for up to 27 months. *See*

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customers."); *Covista Communications, Inc. Announces Intention to Market Local Telecommunications Services and Completion of Credit Facility*, Bus. Wire, Apr. 29, 2003 ("Covista Communications, Inc. . . . intends to . . . utilize the Unbundled Network Element Platform (UNE-P) . . . first in New Jersey and later in other markets throughout the United States."); *see also Revenues for the UNE-P CLEC, at* http://www.isg-telecom.com/une%20p%20clec.htm (visited May 8, 2003) (advising CLECs that they "owe it to [themselves] and [their] investors to look seriously at" UNE-P entry: "Do as the big boys do without the expense").

Order ¶ 532. The prospective harms associated with such continuing obligations are more than sufficient to justify a stay.

A stay is also necessary to prevent the Commission's expansive loop and transport rules – coupled with the harms that will inevitably come with the Commission's relaxation of the rules regarding EELs and its extension of unbundling rights to CMRS providers in certain respects – from causing irreparable injury. Indeed, the Commission itself previously recognized the substantial dislocation that could result from widespread "flipping" of special access services to UNEs. *See Supplemental Order Clarification*, 15 FCC Rcd at 9597, ¶ 18; *see also CompTel*, 309 F.3d at 16. The Commission's new rules – which require pervasive unbundling of transport throughout the country, while dramatically loosening the restrictions on EELs and permitting CMRS providers to access UNEs as described above – necessarily threaten petitioners with substantial harm. Indeed, petitioners demonstrated in the record before the Commission that their collective financial exposure on these issues could amount to *billions* of dollars.

Nor is there any cognizable harm to CLECs resulting from a stay that could offset the staggering losses that ILECs will experience as a result of the Order. A stay of the Commission's UNE rules would leave in place CLECs' ability to resell ILEC retail services at a federally mandated discount. *See* 47 U.S.C. § 251(c)(4). Those CLECs that find themselves without access to the UNE-P will thus be able to avail themselves of resale – the entry vehicle that Congress created for carriers that wished to rely exclusively on ILEC facilities. And those CLECs that require high-capacity transmission will of course still be entitled to order such services from the many competitive access providers in the market, including from the ILECs.

Finally, the public interest likewise favors a stay. As the D.C. Circuit has explained, overly expansive unbundling rules create significant costs, "spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities." *USTA*, 290 F.3d at 427. On the other side of the ledger, the "competition" generated by such rules is "completely synthetic" and does not further "Congress's purposes" — *i.e.*, the promotion of "investment and facilities-based competition." *Id.* at 424. Because the Order imposes overly expansive unbundling rules, a stay will both limit the societal costs that come with such rules and further the 1996 Act's objectives of investment and facilities-based competition.

CONCLUSION

The Commission should issue a stay pending appeal of those portions of the Order discussed above.

Respectfully submitted,

Michael Kellogg /CS

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June 26, 2003

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th H Street, SW, Portals
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Re: CC Docket Nos. 02-33, 95-20, and 98-10

Dear Ms. Dortch:

The attached document was provided to Carol Mattey of the Wireline Competition Bureau today. Verizon is requesting this document be placed on the record of the above proceedings. Please let me know if you have any questions.

Sincerely,

Ann D Berkowitz

Attachment

c: C. Mattey
B. Olson
J. Jackson

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June 26, 2003

Ms. Carol Mattey
Deputy Bureau Chief
Wireline Competition Bureau
Federal Communications Commission
445 Twelfth Street, S.W.
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Re: CC Docket Nos. 02-33, 95-20, and 98-10

Dear Ms. Mattey:

In our meeting in March 2003, you had asked Verizon to address the application of the Commission's accounting and cost allocation rules if the Commission finds that wireline broadband transmission services should be subject to Title I of the Act. Specifically, you asked whether the Commission's existing rules would require the costs of such services to be accounted for as non-regulated. In the attached paper, we show why there is no need for the Commission to apply old accounting rules to new and developing technologies. Indeed, any significant modification of the accounting treatment of broadband costs will create serious disincentives to broadband deployment and undermine the pro-competitive and pro-investment goals of the Commission's new broadband policy.

We look forward to discussing these issues with you in the near future. If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,

W. Scott Randolph

Attachment

cc: Jane Jackson
Brent Olson

ACCOUNTING TREATMENT OF BROADBAND COSTS

The most direct way for the Commission to establish a new, uniform national broadband policy is to reclassify broadband services as non-common-carrier services – a decision that would formally take those services outside the scope of Title II of the Communications Act. The Commission should nevertheless continue to treat broadband services as regulated for accounting purposes only. There is no need for the Commission to mechanically apply old accounting rules to new and developing technologies. Any significant modification of the accounting treatment of broadband costs will create serious disincentives to broadband deployment and undermine the pro-competitive and pro-investment goals of the Commission's new broadband policy.

The nation's current telecommunications network and the services offered over it are vastly different from the network and services used many years ago to define the cost categories in the Commission's accounting rules, as the Commission itself has previously recognized.[1] To change the accounting treatment of broadband services would require the Commission not only to identify broadband costs within an integrated modern network – itself a daunting task with much potential for error – but to extract those costs from accounting categories that were developed long before broadband was invented. This undertaking will breed regulatory uncertainty about which costs may or may not be allocated to broadband services, thus deterring investment and interfering with the market signals and incentives that can and should drive broadband deployment.

Broadband deployment will also suffer if the Commission removes significant federal regulatory obstacles to broadband only to have the states reimpose a patchwork of investment-deterring regulations of their own. Although the states have a role to play in setting rates for common-carrier voice services, it would frustrate the purposes of the 1996 Act for the Commission to allow states to undermine a uniform national broadband policy. The Commission should therefore pre-empt state efforts to regulate broadband either directly or indirectly – for example, by imputing revenues from or allocating costs to broadband services. Most states have adopted price-cap or alternative regulation of local services, so the cost allocation will have no impact on the prices of regulated services in those areas. And, in rate of return states, where rates are based on cost, rates may be based on the cost of a stand-alone voice network, regardless of how broadband is treated within the Commission's accounting system.

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[1] *See, e.g.*, Notice of Proposed Rulemaking, *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, 12 FCC Rcd 22120, 22126, ¶ 9 (1997) (noting development of network since adoption of Part 36 separations rules).

I. The Commission Should Not Change The Accounting Treatment of Broadband for Purposes of Part 64 of the Commission's Rules

The Commission many years ago implemented a four-step accounting process to facilitate the establishment of interstate and intrastate rates at a time when rate-of-return regulation was the norm. First, carriers record their costs in accordance with the Uniform System of Accounts prescribed by Part 32 of the Commission's rules. Second, carriers assign the costs in these accounts to regulated and nonregulated activities under Part 64. Third, carriers separate the regulated costs between the intrastate and interstate jurisdictions in accordance with Part 36. Finally, carriers apportion the interstate regulated costs among the interexchange services and rate elements in accordance with the rules in Part 69.

Of particular concern is the second step of this four-step process. For the following reasons, the Commission should continue to treat broadband services as regulated for purposes of its Part 64 rules, even if they are, as a factual matter, substantially non-regulated.

A. *Definition of Regulated and Nonregulated Activities.* For purposes of distinguishing between regulated and nonregulated activities, the Commission's accounting rules provide in relevant part that "[p]reemptively deregulated activities and activities . . . never subject to regulation will be classified for accounting purposes as 'nonregulated.' . . . Activities that have been deregulated by a state will be classified for accounting purposes as regulated activities. Activities that have been deregulated at the interstate level, but not preemptively deregulated, will be classified for accounting purposes as regulated activities until such time as this Commission decides otherwise."[2] Hence, activities may be largely deregulated at either the state or interstate level without thereby qualifying as "nonregulated" for accounting purposes, even under the Commission's existing rules.

If, as Verizon strongly urges, the Commission preemptively deregulates broadband, then it can and should modify the above-quoted portion of its regulations to indicate that broadband services will be classified for accounting purposes as regulated activities. Alternatively, if the Commission decides to leave its current definitions unchanged, then it should forbear from applying its Part 64 cost allocation rules to broadband.[3] No matter how it is accomplished, the continued treatment of broadband as

[2] 47 C.F.R. § 32.23(a).

[3] The Commission has previously held that the forbearance is in the public interest when it would make the petitioner "a more effective competitor" – a condition clearly satisfied in the case of ILECs who are trying to compete with the entrenched cable companies that currently dominate the provision of broadband in this country (and the long distance carriers in the case of large business services). *See* Memorandum Opinion and Order, *Petition of U S WEST Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, 14 FCC Rcd 16252, 16278-79, ¶ 49 (1999) ("*Directory Assistance Order*").

regulated for accounting purposes is consistent with Commission precedent and accounting policy, as discussed below.

B. *Separations Freeze Order.* The Commission has already adopted a freeze of separation factors in Part 36 to stabilize the accounting process and "reduce regulatory burdens on carriers during the transition . . . to a deregulated, competitive environment in the local telecommunications marketplace."[4] This same policy of avoiding disruptive changes in cost allocations should apply to the treatment of broadband under Part 64. In fact, any attempt to reallocate broadband costs will create an additional layer of complexity that will undermine the very stability that the Commission hoped to achieve with its *Separations Freeze Order*. The Part 64 allocation of costs between regulated and non-regulated services occurs *before* the Part 36 separation of interstate and intrastate costs. Therefore, if DSL is treated as nonregulated under Part 64, costs that were formerly subject to the frozen allocators would be removed from the separations process altogether. This result could potentially lead to further corrective pricing action by either state or federal regulators, thereby heightening the very uncertainty that the *Separations Freeze Order* was designed to minimize. It is far more sensible to leave the Part 64 allocations alone, allow the costs to go though the separations process, and make any necessary adjustments in the interstate jurisdiction under the Part 61 and 69 rules.

C. *Billing and Collection Precedent.* The proposal to treat a nonregulated service as a regulated service for purposes of Part 64 only is nothing new. In the original *Part 64 Order*, the Commission elected to continue to treat interstate billing and collection service as a regulated service for accounting purposes even though the Commission had removed that service from Title II and declined to exercise its Title I jurisdiction over it because the market "is sufficiently competitive to keep exchange carriers from charging unreasonable rates for or imposing unreasonable conditions in the provision of that service."[5] The Commission rejected the assumption that "the jurisdictional separations process results in a misallocation of total billing and collection costs between the interstate and intrastate jurisdictions" and explained that it appeared equally likely "that according nonregulated treatment to billing and collection costs would result in an understatement of interstate costs."[6] As with billing and collection services, there is no basis to expect that including broadband services in the separations process will result in a misallocation of costs between the jurisdictions. In fact, the risk of a misallocation is far greater if the Commission arbitrarily begins stripping costs out of the accounts before the (now frozen) jurisdictional separations process occurs.

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[4] Report and Order, *Jurisdictional Separations and Referral to the Federal-State Joint Board*, 16 FCC Rcd 11382, 11390, ¶ 13 (2001) ("*Separations Freeze Order*").

[5] *See* Report and Order, *Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities*, 2 FCC Rcd 1298, 1309, ¶ 80 (1987) ("*Part 64 Order*").

[6] *Id.* ¶ 81.

D. ***Difficulty of Accounting for Broadband Usage.*** There is an even more fundamental reason to not treat broadband as non-regulated for accounting purposes: It likely is not even possible to apply the current Part 64 cost allocation rules to broadband in any reasonable fashion because broadband services are packet-switched, yet the Part 64 rules require that certain cost allocations be made on the basis of *usage* – a concept applicable to circuit-switched services but almost meaningless in the packet-switched world.[7] Usage is typically measured in Dial Equipment Minutes (or "DEMs"), but the ATM switches routinely used for broadband do not even register DEMs. These same concerns animated the Commission's separations freeze, which was based in part on the "increased use of packet-switched technologies" that "may call into question the continued validity of usage-based separations procedures designed for circuit-switched technologies and services."[8] Mechanically applying old accounting rules to new technologies thus may not even be possible – and any attempt to do so risks massive misallocation of costs and a corresponding distortion of investment incentives.

E. ***Grave Risk to Broadband Investment, Deployment and Competition.*** The dangers associated with flawed accounting rules should not be underestimated. Dividing and allocating the costs of the modern integrated telecommunications network, which is used to provide both circuit-switched and packet-switched services is an exceedingly difficult problem with no clear solution. No simple metric like minutes of usage or bandwidth consumed can be applied across the many different services now offered, so any allocation necessarily becomes complex and, ultimately, arbitrary to some degree. This complexity and arbitrariness will breed uncertainty, which in turn will deter investment.

Allocating costs from regulated services to broadband not only would create pressure to raise broadband prices (which may not be feasible in the competitive environment) but also would simultaneously lower revenues generated from certain regulated services. This combination of decreased broadband profitability and competitiveness plus forced reductions in revenues from other services would dramatically curtail ILEC incentives to invest in broadband. Ill-conceived accounting rules could thus derail the Commission's current efforts to substantially deregulate broadband and unleash market forces to drive investment and deployment of new facilities and services.

The Commission's video dialtone proceeding provides a cautionary example of how the threat of burdensome cost allocation rules can help stifle the deployment of new

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[7] *See* 47 C.F.R. § 64.901(b)(4) ("The allocation of central office equipment and outside plant investment costs between regulated and non-regulated activities shall be based upon the relative regulated and nonregulated usage of the investment during the calendar year when nonregulated usage is greatest in comparison to regulated usage during the three calendar years beginning with the calendar year during which the investment usage forecast is filed.")

[8] *Separations Freeze Order*, 16 FCC Rcd at 11390, ¶ 12 n.32.

services. After years of delay in contentious proceedings over the proper cost allocation rules for the new service, the Commission proposed complicated rules that shifted extensive costs onto video dialtone.[9] The regulatory uncertainty that these proceedings produced helped doom the service, and virtually no LECs deployed it. Recognizing the detrimental precedents being set in the video dialtone proceeding, Congress took the extraordinary step of terminating the proceeding in Section 302 of the Telecommunications Act of 1996. Broadband is too important to our nation's economy and society to allow a similar mistake to happen here.

F. ***Avoid Indirect Regulation.*** Another risk to broadband deployment comes in the form of state efforts to regulate broadband either directly or, more commonly, indirectly by, for instance, imputing revenues from or allocating costs to broadband service. Several states have done just that in other contexts, for example, imputing revenues from affiliate publishing of yellow pages directories for ratemaking purposes. The effect of these improper allocations of revenues or costs is to deny broadband providers the opportunity to profit from their broadband investments. And the predictable consequence is reduced investment, deployment, and innovation in broadband – precisely the opposite of the market-driven investment and innovation that is at the center of the Commission's new national broadband policy. Most states have adopted price-cap or alternative regulation of local services, so the cost allocation will have no impact on the prices of regulated services there. In those few places where rates are based on cost, states can base their rates on the cost of a stand-alone voice network, regardless of how broadband is treated within the Commission's accounting system. In any event, the Commission should pre-empt state efforts to re-regulate, either openly or surreptitiously, the vital, competitive broadband services that the Commission has gone to such trouble to deregulate.

II. 47 U.S.C. § 254(k) Does Not Require a Different Result

A. Section 254(k) Does Not Distinguish Between Regulated and Nonregulated Services

Section 254(k) of the Communications Act reads in its entirety as follows:

> SUBSIDY OF COMPETITIVE SERVICES PROHIBITED.—A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary

[9] *See generally, e.g.*, Second Report and Order and Third Further Notice of Proposed Rulemaking, *Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services under Price Cap Regulation*, 10 FCC Rcd 11098 (1995); Memorandum Opinion and Order, *Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services*, 10 FCC Rcd 11292 (1995).

> cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

Section 254(k) does not, by its terms, refer to the distinction between regulated and non-regulated activities. Therefore, nothing in the text of Section 254(k) requires that any service be treated as regulated or non-regulated for accounting purposes.

Instead, the first sentence in this section prohibits cross-subsidization of competitive services, and the second prohibits the imputation of excessive joint and common costs to services supported by universal service. Both of these problems – subsidization of competitive services and burdening of services supported by universal service – have been effectively eliminated. First, all services are now subject to competition and market forces protect against cross-subsidization. In a competitive market, if a carrier tries to increase rates for some services to subsidize others, competitors would capitalize on that decision and use the rate increase to capture customers in that market. Second, price-cap regulation has now replaced rate-of-return regulation in most markets. Adding costs to the rate base for regulated services no longer allows carriers to increase the price of those services, which are determined by a formula that simply does not take costs into account. The price cap index ("PCI"), as well as limits on increases in the subscriber line charge, restrict a price cap LEC's ability to offset price reductions for services that are subject to competition with price increases for services that are not subject to competition. This ensures that the rates for those services remaining subject to price caps are just and reasonable.[10] Prices for Verizon's interstate services are thus subject to the Commission's price cap rules and are set in a manner that has no relationship to regulated accounting costs.

In addition, where the Commission has found that more competitive services should be subject to less regulation, it has established adequate mechanisms for removing those services from price caps without unduly affecting the rates for the remaining services. Verizon's DSL, interstate frame relay and ATM, and other packet-based broadband services are excluded from price cap calculations today. Removing competitive services from price caps, according to the pricing flexibility framework adopted by the Commission, ensures that rates for customers that remain subject to price caps are not increased to unreasonable levels.

Universal service concerns are also addressed. The prices charged for services included in the definition of universal service are subject to price cap or alternative regulation plans, and are not set according to regulated accounting costs in the jurisdictions where Verizon derives the vast majority of its revenue. Even in those few instances where prices for regulated services are based on rate-of-return costing, state commissions may still base voice rates on standalone costs for narrowband services.

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[10] *See* Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 14 FCC Rcd 14221, 14225, ¶ 3 (1999) ("*Pricing Flexibility Order*").

B. In Any Event, Section 254(k) Does Not Affect the Allocation of Loop Costs

Regardless, Section 254(k) could not affect the allocation of loop costs under any circumstances. This is because the loop is a dedicated, rather than a joint or common, cost of providing universal service. The Commission's *Universal Service Order* defines universal service as including all the functionality of a voice-grade loop, along with local usage.[11] The Commission consciously defined universal service in functional terms, rather than on the basis of tariffed services.[12] Under this comprehensive definition, the loop is a facility installed specifically to allow provision of voice-grade access to the public switched network, and therefore is a dedicated cost of providing universal service. This is consistent with the Commission's "long standing view that the subscriber 'causes' local loop costs, whether the subscriber uses the services for intrastate or interstate calls."[13] All the costs of the loop are incurred simply to provide voice-grade access to the public network – *i.e.*, service within the definition of universal service.

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[11] Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8810, ¶ 63, 8818, ¶76, 8822, ¶83 (1997) ("*Universal Service Order*") (defining universal service to include, among other things, the ability to place and receive calls; "the use of the loop, as well as that portion of the switch that is paid for by the end user . . .necessary to access an interexchange carrier's network"; and the ability to use voice-grade access to the public switched network to call an Internet Service Provider).

[12] *Id.* at 8809-10, ¶ 61.

[13] *CALLS Order*, 15 FCC Rcd at 13000, ¶ 95.